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Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Portals II, Room TW-A325
Washington, DC 20554

***EX PARTE* NOTICE**

Re: *High-Cost Universal Service Support*, WC Docket No. 05-337; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Feature Group IP Petition for Forbearance from Section 251(g) of the Communications Act and Sections 51.701(b)(1) and 69.5(b) of the Commission's Rules*, WC Docket No. 07-256; *Petition of the Embarq for Limited Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Rule 69(a), 47 U.S.C. § 251(b), and Commission Orders on the ESP Exemption*, WC Docket No. 08-8; *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68; *Petition of AT&T Inc. For Interim Declaratory Ruling and Limited Waivers regarding Access Charges and the "ESP Exemption,"* WC Docket No. 08-152; *Petition for Waiver of Embarq*, WC Docket No. 08-160.

Dear Ms Dortch:

Yesterday, August 27, 2008, David Zesiger (by phone), David Bartlett (by phone), Brian Staihr (by phone), Jeff Lindsey (by phone), Jeb Benedict, and I, all representing Embarq, met with: Randy Clarke, Marcus Maher, Jeremy Marcus, Alex Minard, and Don Stockdale with the Office of the Bureau Chief of the Wireline Competition Bureau; Nicholas Degani and Matt Warner with the Competition Policy Division of the Wireline Competition Bureau; Lynne Engledow, Victoria Goldberg (by phone), Al Lewis, Bill Sharkey, and Doug Slotten with the Pricing Policy Division in the Wireline Competition Bureau; and Ted Burmeister, Tom Buckley, Greg Guice, Katie King, and Cindy Spiers with the Telecommunications Access Policy Division in the Wireline Competition Bureau. We discussed Embarq's views on various intercarrier compensation and universal service reform issues in the above-referenced proceedings.

Embarq made several specific points during the meeting. In summary, Embarq:

- Described a proposed solution for reform of the High-Cost Mechanisms in the Federal Universal Service Fund that would promote broadband and stabilize support for the carrier of last resort obligation in price-cap study areas without increasing overall USF support. This proposal is summarized in greater detail below, and Embarq intends to file the full proposal and supporting documents next week.

- Emphasized the need for intercarrier compensation reform to account for the unique circumstances of different parts of the country, and different carriers serving those areas. In this regard, Embarq explained the benefits of its waiver petition to permit unification of interstate and intrastate access rates, specifically manner in which it address the need for company-specific intercarrier compensation reform that recognizes the different economic conditions facing consumers and their providers in rural areas.
- Explained that the Commission cannot and should not mandate any unified rate lower than the cost-based rates specified in section 252(d)(2) for the transport and termination of telecommunications.
- Argued that the Commission does not have jurisdiction to mandate reductions in intrastate access revenues, while leaving open the possibility that the Commission could alter the mechanism by which such revenues are received.
- Demonstrated that where subscriber line charges (SLCs) are at or near SLC caps (which is the case in many of Embarq's study areas), additional SLC increases are not in the public interest because they are competitively biased in favor of providers that are not subject to carrier-of-last-resort (CoLR) obligations, and unfair to consumers in low-cost areas that choose service from a CoLR.
- Emphasized that IP-Originated voice traffic must be treated the same as PSTN-Originated voice traffic when terminated on the PSTN as doing otherwise would violate technological and competitive neutrality and threaten competition and universal service.
- Explained why both the jurisdiction over and appropriate compensation for Dial-Up ISP traffic must be determined based on the physical end points of the calls rather than the numbers dialed.
- Explained the pressing need for basic Phantom Traffic rules, specifically those proposed by USTelecom, even if a unified rate is adopted for all traffic on the PSTN as rural providers will continue to have issues with identifying the responsible party.
- Argued that any numbers-based USF Contribution mechanism must treat be carefully limited to assess only those numbers actually in use and must treat similar uses of numbers the same with respect to assessments.

Embarq commended the Commission for undertaking an effort at comprehensive reform of intercarrier compensation and universal service as both structures are build on a common foundational purpose—to provide support (explicit and implicit, respectively) for universal service. Universal service has stood as a cornerstone of United States telecommunications policy since before the passage of the Communications Act. For most of that time, and consistent with the pervasively-regulated nature of telecommunications markets, the universal service policy has been implemented through carrier-of-last-resort

(CoLR) mandates and compensatory implicit subsidies, particularly through intercarrier compensation (originally settlements and, in recent decades, access charges).

Embarq submitted that the federal system of high-cost support must be reformed to end duplicative support in areas where a free market would produce service without support and also to provide explicit support to all areas where a free market would not provide such service. The current system of high-cost support is plagued both by excess support in some areas and too little support in other areas, particularly as a result of study-area averaging. In brief, the use of average cost calculations assumes that a CoLR's rates will be averaged and, therefore, that higher returns in low-cost areas will offset negative returns in high-cost areas. Competition has invalidated this assumption, however, as competitors charge lower rates and win customers in low-cost areas, thereby reducing the CoLR's revenues and eliminating the higher returns that were implicitly subsidizing the below-cost service in high-cost areas. This is why the Act mandates that subsidies be explicit. Indeed, the Commission has frequently noted that implicit subsidies cannot survive the increasing competition that is raging in the small towns and cities throughout the country. Therefore, high-cost support must be more narrowly targeted in many some study areas, including some rural study areas, to fulfill the directive of section 254 to make universal service support explicit, predictable, and sufficient. In so doing, the Commission can and should also promote broadband deployment consistent with section 706.

Summary of Embarq's Proposal for a Broadband and Carrier-of-Last-Resort Solution (BCS) for Federal High-Cost Support. Embarq suggested that, whether as a part of comprehensive intercarrier compensation, in response to the Recommended Decision of the Federal-State Joint Board, or as a stand-alone action, the Commission could take several readily-achievable steps to substantially improve high-cost support and create a stable foundation for the federal USF. In particular, Embarq summarized a proposal whereby the Commission could stimulate substantial new broadband deployment, stabilize support for CoLR universal service, and create a more-stable foundation for further reform of USF without increasing overall support levels.

Embarq argued that its proposal—the Broadband and Carrier-of-Last-Resort Solution (BCS)—would solve these problems. The basic principle is that price-cap study areas should be converted to more targeted USF support on a wire center basis because implicit support (through study area averaging) does not work for consumers in those areas. The proposal would thereby rationalize high-cost support in the majority of high-cost areas, promote broadband deployment, facilitate other important USF reforms, and indirectly resolve the outstanding questions posed by the 10th Circuit Remand. Finally, the proposal appears to achieve significant progress on the recommendations of the Federal-State Joint Board, while also providing a foundation for accomplishing many of the objectives in the other NPRMs issued by the Commission last fall.

Upon analysis, Embarq explained it is apparent that the problems with the current USF distribution (both providing too much support in some places and too little support in other places) are more acute in (and perhaps largely confined to) areas served by ILECs that are regulated in the federal jurisdiction pursuant to incentive regulation (price caps). Unlike customers served by rate-of-return carriers, rural customers served by price-cap carriers are exposed to the increasing risk of service degradation because price-cap carriers are not permitted to raise end-user or access rates to compensate for eroding CoLR support. Moreover, what explicit USF support is available is capped in price-cap study areas. Finally, as support for the continuing CoLR obligation erodes, price-cap ILECs will increasingly be less able to invest in and maintain their networks, which are used by all broadband and wireless providers. Thus, Embarq also explained that the current failings of federal USF are threatening broadband deployment.

In a nutshell, Embarq described a potential solution in which the Commission would replace the current Non-Rural High-Cost Model Support mechanism (and current High-Cost Loop Support in price cap study areas) with a new Broadband and Carrier-of-Last-Resort Support (BCS) mechanism that supports wire centers with average loop costs greater than a national benchmark. Once established, the BCS would be capped at its initial level, and it would increase only through Commission action, for example, to facilitate any conversion of rate-of-return study areas to price-cap regulation (as done by several ILECs over the past year), in which case, support under other mechanisms would decrease by an amount commensurate with any increase in the BCS.

Embarq explained that no new USF funding would be used to create the BCS. Rather, funding for the new BCS would come from adding access replacement funds (IAS and ICLS) received by wireless carriers to the amount in the current Non-Rural High-Cost Support mechanism and the amount of High-Cost Loop support distributed in price-cap study areas. Embarq explained that this redistribution is in the public interest. In particular, the Commission has tentatively concluded that wireless CETCs should not receive access replacement support. Embarq explained that the Commission could redistribute these funds to both incumbent and competitive ETCs in currently under-funded or un-funded price-cap wire centers under the BCS. Such a redistribution would be competitively and technologically neutral while promoting the public interest in advancing broadband deployment and preserving affordable universal service.

Embarq described how the BCS would promote broadband deployment. BCS support recipients in price-cap areas would commit to make available broadband services of at least 1.5 Mbps downstream to at least 85% of the lines in each wire center receiving support. To promote continuing availability of affordable CoLR service at rates comparable to the rates in more densely-populated areas, Embarq also explained that BCS support recipients in price-cap areas would commit to provide supported local service at rates that meet the statutory requirements of affordability and comparability, which should satisfy the requirements of the 10th Circuit Remand. Embarq suggested that this commitment would be put into practice through a Commission-designated rate benchmark. To the extent a recipient's local rate is below this benchmark in a particular wire center, that recipient would forfeit an amount of support equal to the difference between its actual rate and the benchmark, multiplied by the number of lines served in that wire center.

Embarq explained that rural rate-of-return study areas would be unaffected by the BCS reform proposal, except for the Commission's tentative conclusion that wireless competitive eligible telecommunications carriers (CETCs) should not receive ICLS payments. Moreover, wireless CETCs would continue to receive loop support in rate-of-return study areas, and they would be eligible to receive the funding through the new mechanism for price-cap study areas. Otherwise, USF support in rural rate-of-return areas would continue as it does today even as the reforms in price-cap study areas would put all high-cost areas on more equal footing.

Embarq also described how the BCS can be implemented relatively simply and quickly by using current information and methodologies. Support would be directed at wire centers which, in practice, would be a competitively neutral distribution method in low-density areas as all networks are built out around the few towns and use the same backbone network to connect to the rest of the country. Embarq explained that, rather than support the entire cost of local service, BCS support will be calculated only based on forward-looking loop costs. High-cost loops are the principal reason that high-cost areas are uneconomic to serve, and variations in loop costs are the principal driver of cost differences. Therefore, supporting high-cost loops directly is the most granular and efficient way to ensure universal service. Indeed, Embarq explained that this approach will take steps to harmonize the support methodology for rate-of-return and price-cap study areas as rural, rate-of-return support is currently based largely on loop costs.

Embarq described how, under the BCS, the capped total amount of support would be distributed among the supported wire centers on the basis of relative costs as measured by household densities. To facilitate implementation and minimize legal concerns that would accompany using a new and un-reviewed density allocation metric, Embarq suggested the BCS would use a proxy for a density allocator—the loop cost output in the current iteration of the Hybrid Cost Proxy Model currently used by the Commission. The primary factor for relative loop costs in the model is line density, which is a reasonable estimate of household density. Instead of estimating total cost of local service, the HCPM would be used one last time for the sole purpose to identify estimated loop costs. Embarq also suggested that future assessments could be done (for example, every five years) using a superior model or some other mechanism.

Embarq also proposed that, consistent with the economics of the carrier-of-last-resort obligation, which does not diminish when lines are lost (usually in the relatively low-cost areas to serve such as towns) support levels would not vary with changes in the number of lines served. This would remove the perverse result in the current system where support for high-cost customers (e.g., farmers) goes down as low-cost customers (e.g. people in town) switch providers. Once established, each wire center would receive the same support for five years. Support levels and corresponding obligations would be revisited thereafter at five-year intervals.

Embarq emphasized that this proposal would not necessarily take support away from wireless CETCs, in contrast to the Commission's tentative conclusion in the Reverse Auction NPRM. Rather, these CETCs would be eligible for support under the new BCS mechanism, provided they meet the conditions to build out network throughout each supported wire center and meet the broadband commitment in those wire centers. In particular, the BCS would provide support to a CETC in each wire center, but no more than one CETC would receive support in any given wire center. To receive support, Embarq explained that a CETC must serve the entire wire center using its own facilities (which may include those leased at market rates from other providers) within five years (during those five years, it can use a mix of facilities and resale).

Embarq described how, where there is a single CETC that can make the commitment in a wire center, it would be designated under the BCS as the supported CETC for that wire center. The BCS support for the wire center would be divided equally between the ILEC and the CETC. Where more than one CETC seeks to be designated in a wire center, however, the designating authority (i.e., state commission or FCC) would select a single CETC, for example through an RFP review process or auction. Embarq suggested that, if the winning CETC agreed to provide service for less than 50% of the calculated wire center support, the Commission could use the difference for another purpose such as providing further support for new broadband deployment.

In conclusion, Embarq submitted that the BCS would stimulate substantial new broadband deployment, stabilize support for CoLR universal service, and create a more-stable foundation for further reform of USF without increasing overall support levels. If the Commission were to adopt the BCS, it would make significant progress on the universal service NPRMs it issued last fall, including the Joint Board's Recommended Decision.

Pursuant to Section 1.1206(b) of the Commission's rules, one copy of this electronic notice is being filed in each of the above-referenced dockets. Please contact me if you have any questions or need anything else.

Sincerely,

Jeffrey S Lanning

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cc: Donald Stockdale
Marcus Maher
Jeremy Marcus
Randy Clarke
Alex Minard
Nicholas Degani
Matt Warner
Lynne Engledow
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